Redemption of Preference Shares

Meaning of preference shares

Preference shares are those shares which carry priority rights in payment of dividend at a fixed rate before paying any dividends to equity shares and priority in repayment of capital in case of liquidation of the company.

Features of Preference Shares:

- Preference shares have priority over payment of dividend and repayment of capital.
- The rate of dividend on preference shares is fixed. Only in case of participating preference shares additional dividend may be paid if profits remain after paying equity dividend.
- Except in case of redeemable preference shares, the preference share capital remains with the company on a permanent basis.
- Preference shares do not create any charge over the assets of the company.
- Preference shareholders do not hold voting rights.
- Redeemable preference shares can be paid off, if the company has surplus funds.
- Dividend on cumulative preference shares is carried forward to the next year if company does not have sufficient profits in the current year.

Types of preference shares

(a) Cumulative Preference Shares:

These shares have a right to claim dividend for those years also for which there were no profits. Whenever there are divisible profits, cumulative preference shares are paid dividend for all the previous years in which dividend could not be declared.

(b) Non-Cumulating Preference Shares:

The holders of these shares have no claim for the arrears of dividend. They are paid a dividend if there are sufficient profits. They cannot claim arrears of dividend in subsequent years.

(c) Redeemable Preference Shares:

The company can issue redeemable preferences shares if articles of association allow such an issue. The company has a right to return redeemable preferences share capital after a certain period.

(d) Irredeemable Preference Shares:

The shares which cannot be redeemed, unless the company is liquidated, are known as irredeemable preference shares.

(e) Participating Preference Shares:

The holders of these shares participate in the surplus profits of the company. They are firstly paid a fixed rate of dividend and then a reasonable rate of dividend is paid on equity shares. If some profits remain after paying both these dividends, then preference shareholders participate in the surplus profits.

(f) Non-Participating Preference Shares:

The shares on which only a fixed rate of dividend is paid are known as non- participating preference shares. The shares do not carry the additional right of sharing of profits of the company.

(g) Convertible Preference Shares:

The holders of these shares may be given a right to convert their holdings into equity shares after a specified period. These are called convertible preference shares. The right of conversion must be authorised by the articles of association.

(h) Non-Convertible Preference Shares:

The shares which cannot be converted into equity shares are known as non- convertible preference shares.

Advantages of Preference Shares:

1. Rate of return is guaranteed. Such investors, who prefer safety on their capital and want to earn income with greater certainty always prefer to invest in preference shares.

2. Helpful in raising long-term capital for a company.

3. Control of the company is vested with the management by issuing the preference shares to outsiders as preference shareholders have restricted voting rights.

4. Redeemable preference shares have the added advantage of repayment of capital whenever there is surplus in the company.

5. There is no need to mortgage property on these shares.

6. As a fixed rate of dividend is payable on preference shares, these enable a company to adopt trading on equity i.e. to increase rate of earnings on equity shares after paying a lower rate of fixed dividend on preference shares.

Disadvantages of Preference Shares:

1. Permanent burden on the company to pay a fixed rate of dividend before paying anything on other shares.

2. Not advantageous to investors from the point of view of control and management as preference shares do not carry voting rights.

3. Compared to other fixed interest bearing securities such as debentures, usually the cost of raising the preference share capital is higher.

Redemption of preference shares

Redemption of preference shares means returning the preference share capital to the preference shareholders either at a fixed date or after a certain time period during the life time of the company provided company must complied certain conditions.

Provisions or Conditions relating to redemption of preference shares

The following are the important provisions regarding the redemption of preference shares which are given under Section 80 of the Companies Act:

1. Company must be authorized by its articles of association.
2. No such shares shall be redeemed unless they are fully paid up. The partly paid up shares cannot be redeemed. If they are partly paid in that case a final call be made to convert them from partly paid to fully paid only then redemption can be carried out.
3. Such shares can be redeemed

a. Out of the profit of the company which would otherwise be available for the dividend; or
b. Out of the proceeds of a fresh issue of shares made for the purpose of redemption.

4. If the shares are redeemed out of profits available for the distribution for dividend, a sum equal to the nominal amount of the shares so redeemed must be transferred to reserve account to be called 'Capital Redemption Reserve Account'
5. Preference shares can be redeemed at premium or par but not at discount, then such premium must be provided either out of the divisible profits of the company or out of the company's security premium account.
6. The Capital Redemption Reserve Account can be utilized for the issue of fully paid bonus shares to the shareholders.
7. Redemption of preference shares must not be consider as reduction in the authorized capital.

Divisible Profits
Meaning

The portion of profit, which can legally be distributed to the shareholders of the company by way of dividend, is called the 'divisible profit'.

Profits available for dividend to shareholders are known as divisible profits. only if profits remain after meeting all expenses, losses, depreciation on fixed as well as on fluctuating assets, taxation, writing off past losses and after transferring at least legally minimum amount to reserves.

Divisible profits includes

a) Credit balance of profit and loss appropriations account
b) Reserve fund or general reserve
c) Dividend equalization fund
d) Sinking fund or Debenture redemption reserve
e) Insurance fund
f) Workmen's compensation fund
g) Workmen's accident fund
h) Investment Fluctuation reserve
i) Taxation reserve
j) Any other revenue reserves

The following are not divisible profits

a) Security premium
b) Profits prior to incorporation
c) Development rebate reserve
d) Capital reserve
e) Balance of forfeited shares account

BALANCE SHEET FORMAT IN VERTICAL FORM

Balance sheet of ……………. Company Ltd as on ……….		
Particulars	**Note**	**Amount**
A. Equity and Liabilities		XXX
1. Share Capital		
Equity Share capital		XXX
Preference Share capital		
2. Reserves & Surplus		
Security Premium		XXX
General reserve		XXX
Capital reserve		XXX
Capital redemption reserve		XXX
P&L A/c		XXX
Any other reserves		XXX
3. Non-Current Liabilities		
a. Secured Loans		XXX
b. Unsecured Loans		XXX
4. Current Liabilities		
Creditors		XXX
bills payable		XXX
Bank overdraft		XXX
Provisions		XXX
TOTAL		**XXXXX**
B. Assets		
1. Non-Current Assets		
Fixed Assets		XXX
Land and Buildings		XXX
Plant and Machinery		XXX
Furniture		XXX
Goodwill		XXX
Patents		XXX
Investments (Non-Current)		XXX
Any other fictitious assets		XXX
2. Current Assets		
Stock		XXX
Debtors		XXX
Bills receivable		XXX
Investments (Current)		XXX
Cash and cash equavalents		XXX
TOTAL		**XXXXX**